

**A U D I T O R - G E N E R A L****REPORT OF THE AUDITOR-GENERAL TO LIMPOPO PROVINCIAL LEGISLATURE
ON THE FINANCIAL STATEMENTS OF MAKHADO MUNICIPALITY FOR THE YEAR
ENDED 30 JUNE 2007****REPORT ON THE FINANCIAL STATEMENTS****Introduction**

1. I was engaged to audit the accompanying financial statements of the Makhado Municipality which comprise the statement of financial position as at 30 June 2007, statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages 1 to 25.

Responsibility of the accounting officer for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the basis of accounting determined by the National Treasury, as set out in accounting policy note 1.1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA). This responsibility includes:
 - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
 - selecting and applying appropriate accounting policies
 - making accounting estimates that are reasonable in the circumstances.

Responsibility of the Auditor-General

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on these financial statements based on my audit in accordance with the International Standards on Auditing. Because of the matters discussed in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis of accounting

4. The municipality's policy is to prepare financial statements on the basis of accounting determined by the National Treasury, as set out in accounting policy note 1.1.

Basis for disclaimer of opinion**Corresponding figures**

5. In my previous audit report dated 30 November 2007 I was unable to express an audit opinion on the financial statements of the municipality for the year ended 30 June 2008. The qualification matters have not been adequately resolved and my audit report is modified regarding the corresponding figures.

Unauthorised expenditure

6. The actual operating expenditure totaled R272.3 million and exceeded the adjusted budgeted expenditure of R251.6 million by R20.7 million. I regard the overspending of R20.7 million as unauthorised expenditure in terms of the definition provided in section 1(1) of the MFMA. The unauthorised expenditure was also not disclosed as a note to the financial statements as required by section 125(2)(d) of the MFMA.

Financial statements

7. With reference to paragraph 40 of this Report the financial statements erroneously include the following water and sewerage related transactions:
 - Water revenue, water and sewerage debtors as well as water purchases totalling R13.5 million, R8 million and R101,637 respectively.
 - Since water and sewerage transactions were not ring-fenced, I was unable to determine and obtain the value of water and sewerage related assets, consumer deposits, inventory, trade and other payable, leave provision and expenditure relating to employee costs, general expenses, repairs and maintenance, bad debts and depreciation. The financial statements are consequently misstated by an unquantifiable amount.
8. Supporting documentation to confirm the accuracy of the information and amounts disclosed in the notes to the financial statements as capital commitments of R14.9 million could not be provided.

Property, plant and equipment

9. The change in the basis of accounting necessitated the unbundling of assets and the restatement of the corresponding figures. Although assets were re-valued at a fair value of R608.2 million I was not provided with documentation to support the determination of the values and the process followed. Consequently I was unable to confirm the valuation of the restated carrying value of assets totalling R775.8 million at 1 July 2006.
10. Asset acquisitions totaled R32.1 million for the year under review and supporting documentation could not be provided for acquisitions totalling R21.4 million. I was

unable to confirm the existence, right of ownership, completeness and valuation of the balance.

11. Depreciation is calculated for the full 12 month-period notwithstanding the date of acquisition. Depreciation is overstated with R2.1 million while assets are understated with the same amount.

Cash and bank

12. With reference to paragraph 5 above, deposits totalling R11.5 million that appear on the bank statements and the year-end bank reconciliation as a reconciling item were not accounted for in the accounting records of the municipality.
13. Unidentified deposits totalling R15.3 million appeared on the bank statements and the year-end bank reconciliation as a reconciling item. The deposits were not accounted for and cash and bank as well as trade and other payables are consequently understated with R15.3 million.

Revenue

14. Property rates totaled R9.1 million for the period under review. A reconciliation between the rates base used in the billing system for property rates and the rates base used in the valuation roll was not performed. I could not be provided with sufficient evidence to satisfy myself of the completeness an valuation of property rates.
15. Supporting documentation to confirm the occurrence, completeness and accuracy of rental income, other income and interest charged on consumer accounts totalling R12.3 million could not be provided. Included in the R12.3 million is R3.3 million relating to other income and which does not appear on the trial balance.
16. Due to limited information I was unable to confirm the completeness of electricity income totalling R95.1 million whilst an unexplained difference of R494,968 existed between the trial balance and the R95.1 million disclosed in the financial statements.
17. The accuracy and completeness of refuse and sewerage/sanitation income of R10.7 million could not be verified since detail reports could not be provided.
18. Receipts totalling R1.3 million could not be traced to the bank statements while supporting documentation for receipts for R351,420 were not submitted. Consequently I was unable to confirm the occurrence, cut-off, completeness and accuracy of the receipts.
19. According to paragraph 1.12.1 of the accounting policies, service charges are based on consumption metered and an estimate of consumption between the latest meter reading and the reporting date. The electricity income of R95.1 million is based on consumption metered and an estimate of the income was not made between the latest metered date and 30 June 2007. The records of the municipality did not permit me to determine the estimate.
20. Pre-paid electricity income totaled R8.1 million and the municipality did not perform a reconciliation between the general ledger and the electricity cash power system. I was not able to perform an alternative procedure to determine the completeness of pre-paid electricity since a report could not be generated from the cash power system.

21. Documentation and information pertaining to revenue could not be provided and I was unable to confirm the occurrence and accuracy of R4.7 million.

Accumulated surplus

22. With reference to paragraph 5 above,

- R7.1 million pertaining to long-term debt was incorrectly included in the converted 2005/06 financial year accumulated surplus of R581.4 million.
- Incorrectly included in the converted 2005/06 financial year accumulated surplus of R581.4 million is a net balance of R4.2 million relating to 2005/06 financial year transactions.

23. Net adjustments totalling R14.9 million have been made against the accumulated surplus account for the year under review. Supporting documentation could not be provided to verify the existence, valuation and allocation of the journalised transactions totalling R16.8 million.
24. Revenue and expenditure transactions totalling R1.7 million and R1.4 million respectively are included in the accumulated surplus balance of R14.9 million. The corresponding figures in the statement of financial performance have not been restated as required by the Statement of Generally Recognised Accounting Practice, GRAP 3.42.
25. The municipality closed the 2005/06 financial year with an operating surplus of R9.9 million. The change in the basis of accounting resulted in an operating deficit of R26.8 million for the 2005/06 financial year and is disclosed in the statement of changes in net assets. The material movement totalling R36.8 million was not disclosed in the notes to the financial statements, as required by the Statement of Generally Recognised Accounting Practice, GRAP 3.28(f).

Grants and subsidies

26. An unreconciled and unexplained difference of R2 million existed between the municipal infrastructure grant balance of R25.8 million per sub-note 16.8 and the balance of R23.8 million per note 16.
27. Although the conditions of the integrated national electricity plan (INEP) grant has been met in respect of R410,623, the amount was regarded as revenue. I was not provided with documentation to support the utilisation of the grant and am consequently unable to confirm the occurrence and accuracy of the amount.

Inventory

28. I observed the count of physical inventories on 26 and 27 June 2007. Due to weaknesses in the internal control relating to inventory management and the unadjusted accounting records resulting from the count, I did not obtain sufficient and appropriate audit evidence to satisfy myself as to the existence and completeness of inventories totalling R7 million.

Trade and other payables

29. With reference to paragraph 5 above, a provision of R1.8 million was not made for the arrear councillors' remuneration for the period March to June 2006.

30. Included in the balance of R24.3 million are other creditors of R11.7 million. Supporting documentation could not be provided to verify the existence, obligation and valuation of the R11.7 million.
31. An unreconciled and unexplained difference of R2.6 million existed between the year-end value-added tax (VAT) return and the VAT creditor balance of R3.8 million. I was unable to confirm the valuation of the R3.8 million.

Consumer debtors

32. With reference to paragraph 5 above, consumer credit balances totalling R4.8 million were incorrectly set-off against the consumer debtor balance. Furthermore, despite the council's approval to write-off of debt of R1.2 million, the amount was not removed from the debt balance.
33. Included in consumer debtors are credit balances totalling R9.2 million. These balances were incorrectly set-off against the debit balances. Consumer debtors and trade and other payables are understated with R9.2 million.
34. Note 10 to the financial statements disclosed the different consumer service debtor categories and other debtor gross balance, provision for bad debts and net balances. I was unable to verify the accuracy of these balances due to insufficient information provided.

Other debtors

35. Supporting documentation for other debtors in note 11 to the financial statements, which totalled R2.9 million could not be submitted. I was unable to confirm the existence, rights and valuation of the R2.9 million.

Consumer deposits

36. With reference to paragraph 5 above, an unexplained and unreconciled difference of R749,050 existed between the consumer deposit balance of R3.9 million and the balance of R4.7 million according to the debtor system.
37. The electricity and water deposits balance per note 4 to the financial statements totaled R5.2 million. No detail list of these deposits could be provided to enable me to confirm the existence, obligation and valuation of deposits.

Disclaimer of opinion

38. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have been unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements of Makhado Municipality. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matter

I draw attention to the following matter:

Basis of accounting

39. As set out in accounting policy note 1.1 the National Treasury approved a deviation from the basis of accounting applicable to the municipality in terms of *Government Notice 552 of 2007* issued in *Government Gazette 30013 of 29 June 2007*.

OTHER MATTERS

I draw attention to the following matters that are ancillary to my responsibilities in the audit of the financial statements:

Non-compliance with legislation

Local Government: Municipal Structures Act, 1998 (Act No. 117 of 1998) (Structures Act)

40. Section 84(1) of the Structures Act regulates the functions and powers of a district municipality which includes the provision of potable water supply systems as well as systems for domestic waste-water and sewage disposal. Despite the fact that the Vhembe District Municipality is the water service authority and Makhado Municipality is the water service provider, the municipality accounted for all water and sewerage related transactions in the accounting records. In terms of section 85(1) of the Act the MEC for local government may adjust the division of functions and powers between a district and a local municipality. A government gazette proclaiming the functions and powers and/or adjustment thereto could, however, not be provided, while a valid service delivery agreement between the district municipality and the municipality was not concluded.

Internal control

41. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes of the matters indicated, as they relate to the five components of internal control. In some instances deficiencies exist in more than one internal control component.

Reporting item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
Basis for disclaimer of opinion					
Corresponding figures	X				
Unauthorised expenditure			X		
Financial statements	X		X		
Property, plant and equipment			X		X
Cash and bank	X				X
Revenue			X	X	X

Reporting item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
Accumulated surplus	X		X		
Grants and subsidies			X		X
Inventory			X		
Trade and other payables			X		
Consumer debtors	X		X		
Other debtors			X		
Consumer deposits	X		X		
<p>Control environment: Establishes the foundation for the internal control system by providing fundamental discipline and structure for financial reporting.</p> <p>Risk assessment: Involves the identification and analysis by management of relevant financial reporting risks to achieving predetermined financial reporting objectives.</p> <p>Control activities: Policies, procedures and practices that ensure management's financial reporting objectives are achieved and financial reporting risk mitigation strategies are carried out.</p> <p>Information and communication: Supports all other control components by communicating control responsibilities for financial reporting to employees and by providing financial reporting information in a form and time frame that allows people to carry out their financial reporting duties.</p> <p>Monitoring: Covers external oversight of internal controls over financial reporting by management or other parties outside the process; or the application of independent methodologies, like customized procedures or standard checklists, by employees within a process.</p>					

Control environment

42. The municipality did not establish key elements of a control environment to achieve sound financial management. This resulted in an inadequate level of skills and knowledge to resolve the prior year's qualification matters and the corresponding figures.

Control activities

43. The effectiveness of control activities over the system of filing documentation as well as accountancy processes was not adequate. This is evident from the matters reported on unauthorised expenditure, financial statements, property, plant and equipment, revenue, accumulated surplus, grants and subsidies, inventory, trade and other payables, consumer and other debtors and consumer deposits, as well as the matter raised as other matters.

Monitoring controls

44. The monitoring of controls, such as the review of reconciliations and confirmations from external parties, was not effective. This contributed to the matters reported

relating to property, plant and equipment, cash and bank, revenue and grants and subsidies.

Unaudited supplementary schedules

45. The supplementary information set out on pages 26 to 33 do not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion on them.

OTHER REPORTING RESPONSIBILITIES

Reporting on performance information

46. I was engaged to audit the performance information.

Responsibility of the accounting officer for the performance information

47. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

Responsibility of the Auditor-General

48. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 646 of 2007*, issued in *Government Gazette No. 646 of 25 May 2007* and section 45 of the MSA.
49. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.
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50. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

Audit findings

Non-compliance with regulatory requirements

No reporting of performance information

51. The annual report of the municipality did not include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the MSA, as required by section 121(3)(c) of the MFMA.

Existence and functioning of a performance audit committee

52. The Makhado Municipality did not appoint and budget for a performance audit committee, neither was another audit committee utilised as the performance audit committee.

Internal auditing of performance measurements

53. The Makhado Municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurement as part of its internal auditing processes as required in terms of section 45 of the MSA.

APPRECIATION

54. The assistance rendered by the staff of the Makhado Municipality during the audit is sincerely appreciated.

Auditor-General

Polokwane

10 June 2008



AUDITOR - GENERAL